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CANADIAN-U.S. RELATIONSHIPS IN THE FIELDS OF FINANCE AND TRADE

An address delivered by
W. Earle McLaughlin

Chairman and President, The Royal Bank of Canada


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It is a pleasure to be with you this evening and to be one of the participants in "International Month" in North Carolina. And it is especially satisfying to have as a topic that aspect of international relations that is of particular interest to both Canadians and Americans -- the relationships between their two countries.

Canadian-U.S. relationships in the fields of finance and trade have a long and honourable history; but, like many close relationships, they have been the subject of heated debates and discussions often coloured with emotional rather than rational overtones. From the Canadian side of the affair, these discussions have been fed, not by any visible signs of wrongdoing, but by unfounded anxieties, incorrect analyses, inadequate responses, and inappropriate proposals and policies. Much of this is the natural result of trying to relate to a partner that is overwhelmingly larger. To paraphrase a much quoted statement of our Prime Minister -- the situation may be likened to sleeping with an elephant! No matter how friendly or even-tempered the beast, we are affected by every twitch and grunt.

Let me then talk about Canadian-U.S. economic relationships from the Canadian point of view, since I suspect that at this distance it may be difficult to obtain a clear picture of our side of the relationship. Even in the age of telecommunication satellites it may be hard for an elephant to see what is under his trunk!



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In particular, I should like to discuss the following aspects of our relationships:

What it is like to have a large amount of U.S. investment operating in Canada, where so much of our economic activity is carried out by subsidiaries of U.S. companies. This has been a breeding ground for many unfounded Canadian anxieties.

What it is like to be the recipient of large inflows of U.S. funds into Canada, year after year. This has often been the subject of incorrect Canadian analyses.

What has been the impact of the U.S. balance-of-payments programmes on Canada. This has prompted a series of inadequate responses by Canada.

And, finally, what kinds of policies have been and are being proposed in Canada for "regularizing" our relationships.

Fear of Foreign Domination

Let us look first at the unfounded but pervasive Canadian fear of foreign domination.

The size and extent of U.S. investment in Canadian resources have led to fears about the Canadian economy being dominated by the United States -- being turned into a sort of "branch plant of the United States."

These are what might be called "figure-induced" fears brought on by the bare statistics of U.S. investment and ownership in Canadian industry. They are a reaction to having over \$30 billion of long-term U.S. capital invested in Canada, some two-thirds of it in the form of direct investment. They arise from the knowledge that almost half our manufacturing industries are owned by U.S. residents, and over half our mining and petroleum industries. And, of course, some of our industries, such as the automobile industry, are virtually entirely owned in the United States.

But, are statistics, and only selected ones at that, sufficient to justify fears of domination? It seems to me that the fear of domination, to some extent, implicitly identifies the many U.S. investors in Canada with some national monolith, "The United States." This is certainly a false identification. U.S. investment in Canada is not made by some national entity, but by numerous individual Americans and U.S. corporations for their own separate purposes. In this case, the sum of the parts does not add up to a single unified whole, intent on manipulating the Canadian economy to its own ends.

How then can we explain this fear of domination?

It arises, I think, from the assumption, unfounded in fact, that Canadian corporations owned and controlled by foreigners will act differently from those owned by Canadians and in a way detrimental to the Canadian interest. In other words, it is a business behaviour problem. However, there is no inherent reason why good corporate behaviour should depend on the nationality of ownership. Indeed, one might well expect that foreign-owned corporations would be particularly careful to behave like "good Canadians" in order to be accepted in the Canadian community where they have chosen to do business.

Certainly, whatever careful factual research that has been carried out indicates that Canadian companies owned or controlled by foreign investors are, as a rule, good corporate citizens. A recent official report by our Department of Industry, Trade, and Commerce confirms this impression. It found that the Canadian subsidiaries of foreign corporations had been increasing their use of Canadian sources of supply, reinvesting their profits in Canada, and seeking out international markets for exports. The last point is particularly important

to Canada, for export earnings account for some twenty per cent of our national income.

In short, there seems to be no basis in fact, and certainly none in my own experience, for assuming that foreign-owned or controlled Canadian corporations will behave in ways inimical to the Canadian interest. Corporate behaviour is not a "real" problem of foreign investment.

The real problem is of a different order, and is not peculiar to Canadian-U.S. relationships. It is the problem I have termed "legalistic border-hopping" -- a political, rather than an economic, problem. And it is a world-wide problem associated with the rise of the so-called "multi-national firm." However, since we are dealing with Canadian-U.S. relationships, let me illustrate this problem of legal "overflow" in the Canadian-U.S. setting.

For example, the U.S. Government may, quite appropriately and in keeping with its own goals and policies, forbid its residents to export certain goods to certain countries. There is no problem here for Canada. However, there is a problem if the U.S. Government puts pressure on U.S. parent companies to forbid their Canadian subsidiaries to export to a designated country, even though exports to that country are perfectly legal under Canadian law.

In another instance, U.S. law has attempted to restrict the participation of Canadian subsidiaries in export associations approved by the Canadian authorities.

This legal overflow can also occur outside the export field. For example, the U.S. Securities and Exchange Commission (S.E.C.) has sought to extend its financial regulation of U.S. companies to certain Canadian corporations, even though their shares are unlisted on any U.S. stock exchange.

Actions like these are powerful irritants in Canadian-U.S. relationships, and must be strongly resisted. But resisting the intrusion of foreign law does not need to mean shutting out foreign investment.

What is important to realize here is that foreign investment itself is not the cause of this legal overflow. It is merely the channel through which laws flow across national boundaries. The problem is a political one and one that will grow as the multi-national corporation grows and with it the network of foreign-investment channels. The solution must also be political. And here I hope that Canadian-U.S. relationships, with their long tradition of consultation and co-operation, will provide a solution -- a solution which will not only eliminate the only valid grounds for Canada's fear of foreign domination, but which might also serve as a guide to solving this problem in other areas of the world.

While I can't give you a solution to this problem I do have a concrete idea as to how the problem can be tackled. Early this year I was invited to appear before a Committee of the House of Commons in Ottawa to discuss this matter, and I would like to tell you briefly what I said. It was simply this: Welcome foreign capital, but keep foreign laws out of Canada. The Committee asked me how to do this and I had to reply that I was neither a lawyer nor a diplomat but that our energies over the past many years have been concentrated in trying to solve the wrong problem. If we put as much energy into tackling how to raise our invisible legal border high enough so that foreign laws could not cross it, then we would achieve something. I told the Committee that, if I accomplished anything in appearing before them,

it was to direct their attention to the real problem, even though I could not solve it.

Dependency on Inflows of U.S. Capital

The second aspect of Canadian-U.S. economic relationships that I want to talk about this evening is the heavy net inflow of U.S. capital that comes into Canada year after year. In the last five years of the 1960's, for example, over \$6 billion net of long-term capital flowed into Canada from the United States -- over a billion dollars a year.

The Canadian attitude towards these enormous capital inflows is one of curious contradiction. For despite their fears about the large amount of U.S. capital already invested in Canada, many Canadians are equally afraid that these heavy annual inflows will cease!

What accounts for this almost schizophrenic attitude towards U.S. capital? It is, I think, the result of incorrect analyses of Canada's balance-of-payments position.

Many Canadians believe that large inflows of U.S. capital are needed to pay for the usual deficit on current account in the Canadian balance of payments. They see the current-account deficit as a clear sign that Canada, like a prodigal son in the family of nations, is wasting her substance in riotous living and is forced to borrow abroad to finance these "excesses." Indeed, it is frequently assumed, both in Canada and abroad, that Canada must scrounge the capital markets of the world or face national bankruptcy. And for many Canadians viewing the annual inflows of U.S. capital, the fear of bankruptcy is stronger than the fear of foreign domination.

This fear of bankruptcy is as groundless as the fear of domination.

Canada does not need capital inflows and a surplus on capital account whenever she has a deficit on current account. To argue so is to use "backwards" analysis. The causal relationship is just the reverse. The greatest single reason for Canada's prevailing deficit on current account is her prevailing surplus on capital account.

The capital account is placed in a position of surplus by the decisions of private investors in the United States and elsewhere who opt to put their funds in Canada because they consider it a growing economy offering good opportunities for gain. And if this net inflow of "money capital" is to be transformed into "real capital" in the form of goods, services, technology, plant, machinery, and equipment, the surplus on capital account must be offset by a deficit on current account. Hence, the current-account deficit, the source of so much "guilt feeling" in Canada, is merely the vehicle by which the real capital content of capital flows gets into Canada, and so is a source of strength.

In short, the large inflows of investment capital into Canada are signs of a growing and prosperous economy, and not of deferred bankruptcy. If analysis of the relationship between Canada's capital-account surplus and current-account deficit would get out of "reverse" and at least into "neutral," Canadians might lose their "guilty" feeling of dependence on U.S. capital. This would improve Canadian-U.S. relationships in general, and would encourage more adequate Canadian response to developments such as the U.S. balance-of-payments programmes.

In the analysis which I have just given to you I have tried to refute what I think is the wrong thinking and unnecessary worrying of those concerned about Canada's traditional current-account deficit. This year, perhaps surprisingly, Canada most likely will have a current-account surplus. I am looking forward with interest to see what the professional worriers about the current-account deficit will worry about now.

Canadian Response to U.S. Balance-of-Payments Programmes

Canada's response to the various U.S. balance-of-payments programmes, that began with the Interest Equalization Tax in 1963, has been a sad story of seeking exemptions. To make another biblical allusion, it might be said that Canada, over the past seven years, has been selling her birthright, the right to independent economic policies, for a mess of pottage -- exemptions of doubtful value from restraints on U.S. capital flows to Canada.

This pattern of response, while in contradiction to fears of U.S. domination, is consistent with the erroneous sense of dependency on U.S. capital. It is unfortunate that the sense of dependency won out, for the price of exemptions has been high.

In July, 1963, in what seems to have been an over-reaction to the Interest Equalization Tax, Canada bought exemption by agreeing to maintain a ceiling on her reserves of gold and foreign exchange. This ceiling was originally set at \$2.7 billion. As the U.S. balance-of-payments programmes were intensified and guidelines placed on U.S. investment abroad, the price of exemptions rose and the ceiling on Canadian reserves was lowered -- to \$2.6 billion at the end of 1965, and to \$2.55 billion in 1967.

This constraint on Canada's reserves was in direct conflict with the type of monetary policy indicated for a country which, by this time, was entering into a period of inflation. Monetary restraint was made more difficult because it meant higher interest rates that would attract inflows of foreign funds to swell Canadian reserves already pressing against the ceiling.

The short-lived, and completely unnecessary, exchange crisis of 1968 led indirectly to further inhibitions on Canadian economic policy. The run on the Canadian dollar in early 1968 was triggered by a gross misinterpretation, at home and abroad, of the effect on Canada of U.S. mandatory capital-investment guidelines announced on January 1st of that year. True to form, Canada again sought exemption, again at a higher price. This time the price took the form of guidelines, imposed by the Canadian Government but approved -- or should I say, to use a mild word, "suggested" -- by the U.S. Government, to prevent Canada from becoming a "pass-through" for funds from the United States to third countries. These guidelines, still in effect, restrict the allocation of funds by Canadian banks, by other financial institutions, and by non-financial corporations.

Much of this story of exemption-seeking and inhibiting restrictions was the result of Canada's groundless, but potent, sense of dependency on U.S. capital inflows.

If Canada, in her exemption-seeking negotiations with the United States, had presented her current-account deficit, which is mainly due to a deficit with the United States, not as a sign of desperate need for financing but as the result of capital inflows, largely from the United States, the price of exemption might well have

been lower. Had it been pointed out that any restriction on U.S. capital investment in Canada would mean a reduction in current Canadian purchases of U.S. goods and services, and hence a worsening of the U.S. balance of payments on current account, Canada's bargaining position would have been much stronger. Perhaps the Canadian authorities did point this out and their U.S. counterparts failed to recognize the situation.

The other "villain" in the story, as I have pointed out on other occasions, was Canada's adherence to a fixed-exchange rate. To protect the parity established for the Canadian dollar in 1962, the Canadian Government was prepared to pay the price -- the giving up of the right to operate Canadian economic policies exclusively in the interests of Canada. Indeed, Canada's responses to the U.S. balance-of-payments programmes conform perfectly to the tendency of the present international monetary system to, as Professor Harry Johnson has so aptly put it, "place a high premium on visible suffering and an equally high discount on visible intelligence."

Now that Canada has abandoned the fixed-exchange rate and need no longer seek exemptions to remove real or imaginary threats to a fixed parity, it is to be hoped that more appropriate responses to the U.S. balance-of-payments programmes, and to the more general problem of international monetary arrangements, will prevail.

Canadian Proposals and Policies

Having presented some Canadian viewpoints about the current state of Canadian-U.S. economic relationships, I would like to examine some of the Canadian proposals for "regularizing" these relationships --

for setting the rules on how to handle the elephant. Unfortunately, many of the most publicized proposals hark back to the unfounded anxieties about U.S. domination and group themselves under the catchy, but vague, banner of "buying back Canada."

Just what is to be bought and with what is not clearly specified. The objective is apparently to reduce foreign direct investment in Canadian subsidiary corporations and replace it with foreign fixed-interest investment in bonds issued by Canadian corporations and public bodies. In other words, Canadians would acquire minority interests in foreign-owned subsidiaries by borrowing the necessary funds from abroad.

How this would benefit Canada is hard to see.

The acquisition of minority interests in foreign-owned firms would not give Canadians control over these firms. Nor is this Canadian control necessary since, as I said earlier, foreign-owned firms behave, on the whole, in an exemplary fashion. The substitution of foreign debt, for foreign equity investments, would have only negative effects on the Canadian economy. A reduction in foreign direct investment would mean a reduction in its fringe benefits -- technology or "know-how" and access to international marketing organizations. An increase in foreign debt investment would impose on Canada the burden of fixed-interest payments abroad and, for the first time, give reality to the now groundless fears that Canada, the international debtor, would be called to account on some day of reckoning.

To these costs of buying back Canada, which are based on the assumption of successful repurchase, I would also add the costs to be incurred in attempting to implement the scheme -- namely, the needless

dislocation of international capital markets, which should be free to set the appropriate balance between debt and equity financing; the consequent decrease in over-all capital inflows into Canada with adverse repercussions on our economic growth; and the needless expansion of the government sector, inevitable whenever policy is set in defiance of market forces.

Despite these evident costs, the buy-back fever seems recently to have flared up again in some parts of the Canadian body politic, and is now manifesting itself in what can best be described as a "rash of ratio idiocy."

Last August, the House of Commons Committee, before which I appeared, issued a report. They made some suggestions to solve the real problem of legal overflow from the United States. However, they apparently were not convinced by my arguments that all other problems were imaginary, for one of their major recommendations is for a guideline to limit foreign ownership in Canadian industry to 49 per cent. And this, despite their explicit recognition that it might involve a "massive misallocation of scarce Canadian capital resources;" that it might "tend to reduce the inflow of foreign capital and the knowledge, techniques, skills, and markets which often accompany such capital;" and that it might "restrict desirable resource and industrial development!"

The report, in effect, condemns its own proposal. And the recommendation cannot be rescued by saying that it should be implemented only "over a reasonable period of time and with due regard to varying circumstances." Even the chairman of the Committee had admitted that the proposal may never be enacted and might not even be practical.

If a 49 per cent general limit on foreign ownership is impractical, the 25 per cent limit proposed recently by one of Canada's minority political parties is even more so. Indeed, one of that party's members, appearing before one of your Congressional sub-committees, predicted that U.S. corporations operating in Canada have nothing to fear in the near future.

I suggest they will have nothing to fear in the distant future either, and that this recent outburst of "percentage paranoia" will disappear with the summer heat waves that may have brought it on.

One source of sensible opposition to limits on foreign investment will be our provinces, especially the slower-growth ones. They are well aware of the importance of capital investment for economic growth, and painfully aware of the scarcity of this needed capital. They can be expected to resist any policies that might reduce the flow of capital to them. This is one instance where I welcome the "disunifying" forces of our provinces -- they provide a useful check against inappropriate national policies.

What Canada's foreign-investment policy will finally be is yet unknown. The next signpost will be the long-awaited report on foreign ownership by the Minister of National Revenue, Herbert Gray, due later this year. Since this will be a cabinet-level report, prepared with ample time for reflection, we can hope that it will be more sensible and more practical than the ones mentioned previously.

To reiterate my own policy very briefly -- foreign capital, including U.S. capital, is essential to Canada's prosperity and growth. The free flow of capital across our border should be encouraged, and foreign capital should be welcomed in Canada. But foreign law and

regulation should stop at the border. Blocking the intrusion of foreign laws should be possible without restricting the flow of capital, particularly within the context of Canadian-U.S. relationships, through inter-governmental consultation. This is what I hope we will achieve in the coming years, and it is a hope shared by many other Canadians.

If, in the days to come, you hear more disquieting talk about the issue of foreign investment in Canada, I hope my remarks this evening will reassure you that it is not unanimously shared. When the debate has again died down, I am sure we shall find our relationships in finance and trade continuing to our mutual benefit -- if wisdom prevails, as I feel it will.

